



Treasury Inspector General for Tax Administration

EVALUATION OF THE CHARACTERISTICS OF UNNECESSARILY FILED INDIVIDUAL INCOME TAX RETURNS

Issued on August 17, 2007

Highlights

Highlights of Report Number: 2007-40-130 to the Internal Revenue Service Commissioner for Wage and Investment Division.

IMPACT ON TAXPAYERS

Many people who do not meet the filing requirements file Federal income tax returns, either to obtain a refund of taxes already paid or because they do not understand the law. To reduce the cost to taxpayers who file these tax returns, the Internal Revenue Service (IRS) should direct taxpayers to free electronic filing (e-filing).

WHY TIGTA DID THE AUDIT

Every individual with gross income that equals or exceeds certain limits for a taxable year is required to file a Federal income tax return. However, many people file unnecessary tax returns at a cost to both filers and the IRS. The objective of this review was to determine the steps the IRS has taken or plans to take to reduce the number of unnecessary tax returns filed, including the means used to notify and educate taxpayers that they may no longer be required to file tax returns.

WHAT TIGTA FOUND

More than 8 million individual income tax returns were unnecessarily filed in each of the 3 years reviewed. For the purposes of this report, an unnecessary tax return is defined as a return filed either to obtain a refund of taxes already paid or because the individual did not understand the tax law, even though the individual's income did not meet the filing threshold. Collectively, taxpayers spent an average of \$390 million and 75 million hours per year preparing and filing these unnecessary tax returns, and the IRS spent an average of \$11 million to process the unnecessary tax returns each year.

Taxpayers may file unnecessary tax returns only to obtain a refund of taxes already paid or because they do not understand the tax law. Fifteen percent of the unnecessary tax returns filed did not generate a refund, while 85 percent of these returns were filed to obtain a full refund of withheld taxes. More than one-half of those

filing to obtain a refund were under age 21, and 76 percent of those under age 21 indicated they could be claimed as dependents on other taxpayers' returns. These taxpayers would have been exempt from tax withholding because they earned less income than the amount required to file a return *and* they could be claimed as dependents on other taxpayers' return. More than 60 percent of the unnecessary tax returns were filed on paper.

The IRS could, at a minimum, reduce its burden if taxpayers moved from preparing and submitting their returns on paper to *e-filing*. It costs more to process a paper tax return than an electronically filed return. Fewer mistakes are made by both taxpayers and the IRS with electronically filed tax returns, further reducing processing time and costs. Generally, all the taxpayers filing these unnecessary tax returns would qualify to use the IRS Free File Program, which is a free Federal tax preparation and *e-filing* program for eligible taxpayers. The Free File Program may offer the best opportunity to direct taxpayers from paper filing to *e-filing*.

WHAT TIGTA RECOMMENDED

Due to concerns about the potential negative consequences of advising taxpayers to claim exemption from withholding, TIGTA made no recommendations at this time. In addition, in a recent report entitled *Additional Action Is Needed to Expand the Use and Improve the Administration of the Free File Program* (Reference Number 2007-40-105, dated June 28, 2007), TIGTA recommended the IRS expand the marketing of the Free File Program by directing promotional materials to taxpayers who are eligible for the Free File Program but have filed their returns on paper.

While TIGTA made no recommendations in this report, key IRS management officials reviewed it prior to issuance and agreed with the facts and conclusions presented.

READ THE FULL REPORT

To view the report, including the scope and methodology, go to:

<http://www.treas.gov/tigta/auditreports/2007reports/200740130fr.pdf>.

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